US Embassy Jakarta
ECONOMIC SECTION

INDONESIA:
ENERGY HIGHLIGHTS JUNE 2005

Summary

- The Government of Indonesia (GOI) opened a first round tender for 27 oil and gas blocks on June 9 and, as an incentive, offered new contractors an exemption from VAT requirements during their exploration period.
- State-owned gas company PGN signed a gas sales agreement with 48 industrial users in East Java.
- The Indonesian firm PT Maleo Energi Utama signed an exclusivity agreement to supply gas to a planned mini LNG plant in Sulawesi.
- Cash flow problems at state oil and gas company Pertamina during June 2005 disrupted fuel supplies and resulted in fuel shortages in a number of areas.
- The recent run-up in international crude oil prices will drive up Indonesia's fuel import bills and increase spending on fuel subsidies.
- Delays in fuel deliveries in June disrupted the power supply to the Java-Bali grid, with three large power plants facing disruptions to their operations.
- State electricity company PLN has requested additional supplies of subsidized fuel to meet growing power demand on the Java-Bali grid.
- The Ministry of Energy and Mineral Resources (MEMR) hopes to increase coal production in Indonesia through 2025, and Indonesia's coal companies are set on expansion mode.

Tender of 27 Oil and Gas Blocks

The MEMR open a first round tender for 27 oil and gas blocks on June 9, some of which are leftover from previous tender rounds. The MEMR will offer 14 blocks located in West Natuna, Eastern Java, offshore Lampung, Makassar and West Papua through a standard tender process. It will offer the remaining blocks through a "direct offer" mechanism where interested bidders can submit proposals directly to the ministry. Contractor after-tax splits for these blocks range from 25-35 percent for oil and 30-40 percent for gas. Under both the tender and direct offer mechanisms, contractors must pay a minimum signing bonus of USD 500,000. In addition, the MEMR requires contractors to submit a payment guarantee equal to 70 percent of the signature bonus. The MEMR estimates that exploration investment in the 27 blocks could reach USD 350 million during the first three years.

As an investment incentive, the MEMR has announced that new contractors will be free from value added tax (VAT) requirements during the exploration period. The functioning of Indonesia's VAT system is an issue of significant concern to the oil and gas industry. In December 2003, the Ministry of Finance (MOF) issued a decree terminating the ability of PSC contractors to collect VAT on purchases they make from vendors. Instead, the MOF was required to verify that vendors were paying VAT to the State Treasury before reimbursing the contractors. Although normal VAT reimbursement should not take longer than 120 days, the revised system caused severe delays. The Indonesian Petroleum Association (IPA) reported overdue VAT reimbursements reached more than USD 290 million as of June 2005. The MoF revoked the 2003 decree in January 2005 via MoF Decree No.11/PMK.03.2005, which reinstates PSC contractors as VAT collectors. However, contractors continue to urge the prompt payment of overdue VAT reimbursement claims, and highlight the importance of improving Indonesia's tax system to boost the country's competitiveness.

Gas Supply Contracts Signing

On June 10, state-owned gas company PGN signed a gas sale Memorandum of Understanding (MOU) with 48 industrial customers in East Java. Gas demand from price-sensitive industrial customers in East Java has increased rapidly as a result of soaring international oil prices. The MOU follows the signing of a Gas Sales Agreement (GSA) on May 31 under which Santos Pty Ltd agreed to sell its entire reserves in Maleo field of the Madura Offshore Production Sharing Congract (PSC) to PGN. The GSA covers a total volume of 243 trillion British Thermal Units (TBTU) and is reportedly valued at USD 550 million. First gas delivery is scheduled in 2006 for an eight-year period. Although the GSA helps PGN to partly secure a supply of gas for its East Java customers, many firms remain on a waiting list for gas supply.

The Indonesian firm Medco and state oil and gas company Pertamina signed an exclusivity agreement on June 8 with LNG International, Ltd (LNGI), a listed Australian LNG company, for LNGI's 800 billion cubic feet (Bcf) Senoro gas field. The gas will supply LNGI's planned mini LNG plant in Luwuk, Central Sulawesi. Plant completion is scheduled for the end of 2007 with a capacity of 700,000 tons per year. The LNG project will reportedly cost USD 160 million and will be jointly financed as a joint venture by LNGI and PT Maleo Energi Utama. The exclusivity agreement is for 120 MMSCFD and is subject to approval by upstream authority BP MIGAS.

Pertamina Cash Flow Problems Hurt Fuel Stocks

Cash flow problems at Pertamina in June led to drops in nationwide fuel stocks to 17 days worth of supply. The stock of premium gasoline dropped to only 12 days. A number of areas including the cities of Semarang, Surabaya, Medan and Makassar, reported fuel shortages, and motorists queued at petrol stations waiting for fuel supplies to arrive. Pertamina admitted cutting fuel supply quotas by an average 10 percent, and said it plans to import additional fuel to gradually increase national fuel stocks to 22 days by beginning of August.

Increases in international oil prices to over USD 60 per barrel have dramatically increased the costs of fuel imports. Under the revised FY 2005 budget, Parliament allocated Rp 76.8 trillion (USD 7.9 billion) for fuel subsidies with an oil price assumption of USD 45 per barrel. However with oil prices nearing USD 60/bbl, subsidy spending could reach an estimated Rp 100 trillion (USD 10.3 billion) or more. At this rate, the allocated subsidy for 2005 would be exhausted by October. Pertamina President Director, Widya Purnama, indicated his company will require additional funds of Rp 12.6-14.6 trillion (USD 1.3-1.5 billion) to restore fuel stocks back to normal levels. It is unclear where Pertamina would obtain these funds. Pertamina is reportedly trying to secure a USD 550 million bridge loan from local banks, but the firm may have difficult securing financing given its ongoing cash flow problems.

Power Supply Down in Java and Bali

Delay in fuel delivery contributed to power shortages during June 2005 in parts of Java and Bali. According to press reports, three power plants with a combined daily fuel requirement of 10,000 kilolitres experienced fuel shortages during the month: Grati (750 MW), Tambak Lorok (1,000 MW), and Muara Tawar (850MW). At one point, fuel stocks at Tambak Lorok reportedly declined to only two days' supply, and Muara Tawar's operations were disrupted due to fuel supply problems. On June 20, Grati reportedly ran out of fuel and ceased operation for two days. As a result of the disruptions, power deficits on the Java-Bali grid] reached 450 MW and PLN cut power to certain areas, causing a series of rotating blackouts. PLN also requested its customers to continue to conserve electricity during peak periods.

In contrast, PLN successfully managed power supply during repairs to the pipeline from BP's Offshore Northwest Java (ONWJ) gas field earlier in June, and no blackouts were reported. However, with no new power plants coming online in 2005 and uncertainty over fuel supplies, more blackouts are expected as the dry season approaches.

PLN Request Additional Subsidized Fuel

In June 2005, PLN requested from Pertamina an additional allocation of 3 million KL of subsidized diesel fuel, which would raise its total 2005 allocation from 8.4 million KL to 11.4 million KL. PLN requires additional fuel to meet increasing power demand, particularly in Java and Bali, which have registered a 7-percent increase since the beginning of 2005. Pertamina sells diesel fuel to PLN up to PLN's quota level at a subsidized price of Rp 2,200 per liter, much cheaper than the international market price of approximately Rp 4,000/liter. However, Pertamina has refused to sell additional subsidized fuel to PLN above its quota. Although the MEMR indicated it will not allow power blackouts to occur because of fuel shortages, it is unclear which company will be forced to absorb the extra cost. The GOI may wait until October 2005 to determine whether it needs to request Parliament to increase the national quota above its current level of 59 million KL.

Domestic Coal Demand, Supply Projected to Increase

The MEMR announced in June 2005 that it is targeting coal production increases of 8 percent per year over the next 20 years, to reach approximately 300 million tons in 2025. Given high international coal prices, major Indonesian coal producers, including Kalimantan Prima Coal (KPC), Adaro and Arutmin, plan to expand production. Coal production in Indonesia reached 132 metric tons (MT) in 2004 and is projected to reach 150 MT in 2005. In line with its May 2005 National Energy Blueprint, the MEMR plans to allocate around 33 percent of coal production for domestic use, with the rest going to exports. Growing domestic demand currently comes mainly from the industrial sector, where uncertainties over fuel prices and supply have led industries such as cement, and textile to switch to coal. Longer-term growth in domestic coal demand will be largely dependent on the development of new, coal-fired power plants. Since such plants are mostly in the preparation stage, a significant increase in domestic coal demand is not expected until 2009.